No. 22507-A

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

Everette H. Williams,

Appellant,

vs.

Rose City Development Company, Inc.,

Appellee.

On Appeal From the United States District Court for the District of Oregon.

BRIEF OF APPELLANT.

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BRIEF OF APPELLANT.

Jurisdiction.

This is a controversy arising in a proceeding in bankruptcy, involving conflicting claims to the proceeds of the bankrupt's accounts receivable. This Court has jurisdiction of the appeal from the final order below under Section 24a of the Bankruptcy Act, 11 U.S.C. §47a.

Statement of the Case.

This is an appeal by the trustee in bankruptcy of Portland Newspaper Publishing Co., Inc. from the final order of the District Court made November 7, 1967, insofar as that order upheld a secured claim of

appellee Rose City Development Company, Inc. [C. Tr. 115].*

Portland Newspaper Publishing Co., Inc. was adjudicated bankrupt upon an involuntary petition filed by wage claimants on October 15, 1964 [C. Tr. 6]. Following a general reference of the proceeding to Referee in Bankruptcy Estes Snedecor, appellant was appointed trustee.

The present controversy involves rights in the proceeds of the bankrupt's accounts receivable. Claims based upon alleged security interests in the accounts were filed by R. Anthony DuBay [Ex. 16], Robert J. Davis [Ex. 15], and appellee Rose City Development Company, Inc. [Ex. 17]. Appellee conceded that its position was junior to that of DuBay and Davis.

Appellant objected to all of the secured claims and sought to preserve the liens or security interests for the benefit of the bankrupt estate. He asserted various theories; the one applicable to appellee's case was that the security interests were voidable preferences to the extent they attached to accounts arising within four months of bankruptcy.

Following a trial, Referee Snedecor, by order dated February 9, 1966, sustained the objections. The DuBay and Davis claims were entirely invalidated, and appellee's was voided on the preference ground [C. Tr. 59].

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*The citation "C. Tr." in this Brief refers to the Clerk's Transcript which is Volume I of the Transcript of Record. The reporter's stenographic record of the proceedings before the Referee in Bankruptcy comprises Volumes II through V of the Transcript of Record and is referred to as "R. Tr." The various exhibits are referred to by the designation "Ex." and the identification number assigned to them by the Referee.

Appellee filed its Petition for Review on March 11, 1966 [C. Tr. 72]. DuBay and Davis also sought review. On August 22, 1967, Chief Judge Gus J. Solomon rendered his opinion, affirming the Referee as to DuBay and Davis, but reversing as to appellee and allowing its secured claim [C. Tr. 89]. The final order was entered November 7, 1967 [C. Tr. 115].

On December 5, 1967, appellant filed his Notice of Appeal to this Court with respect to that portion of the order below which sustained the secured claim of appellee Rose City Development Company, Inc. [C. Tr. 117].

Statement of Facts.

In November 1959, Portland's two daily newspapers were struck by various local unions. On February 4, 1960, certain labor unions affected by the strike formed Portland Reporter Publishing Co., Inc. (hereinafter "Reporter"), the predecessor of the bankrupt, for the purpose of continuing publication of a paper. Eighty-eight local unions concurrently sponsored the incorporation of appellee Rose City Development Company, Inc. (hereinafter "Rose City"), which was to acquire business premises and lease them to the Reporter [C. Tr. 2].[1]

From 1960 to the time of bankruptcy in October 1964, the Reporter, and the bankrupt as its successor, continuously operated at a loss, relying upon loans, favorable rental agreements, contributions, and the sale of stock for operating capital [C. Tr. 2-4]. Among other well-wishers, Rose City loaned money to the Re-

[1]The Referee's opinion contains comprehensive findings of fact [C. Tr. 1-59]. These findings are substantially undisputed except as to the matters concerning the bankrupt's insolvency and appellee's knowledge thereof.

porter at various times on an emergency basis to meet payrolls, taxes, and other expenses [C. Tr. 52; R. Tr. 28, 211, 236]. As evidence of the sums of moneys so loaned, the Reporter executed promissory notes in favor of Rose City in the amounts of $45,-000.00 and $10,300.00 on November 16, 1963 and November 22, 1963, respectively [Ex. 17].

To secure the two notes, Rose City and the Reporter entered into a security agreement dated November 22, 1963. The agreement, among other things, granted to Rose City a security interest in "all accounts receivable of the debtor now existing or hereafter arising . . . except those heretofore assigned as disclosed by financing statements filed prior to the date hereof until such accounts so assigned are released," "all contract rights of the debtor now existing or hereafter arising relating to sales of goods or performance of services or both in the course of the debtor's business," and "proceeds and products of all of the above." [Ex. 17].

R. Anthony DuBay and Robert J. Davis also were providing financial assistance to the newspaper. They, too, sought security in the Reporter's accounts receivable, and there was excepted from the collateral made subject to the Rose City security interest those accounts assigned to DuBay and Davis [C. Tr. 35; Exs. 15, 16, 17].

The Rose City security agreement permitted the Reporter to collect and use the receivables and the proceeds as its own, without imposition of any policing or accounting requirements [Ex. 17]. Except for one brief period when a default had been declared [Ex. 39; *Cf.* R. Tr. 146-147], Rose City in fact exercised no supervision of the collateral [C. Tr. 35].

Under the provisions of the Uniform Commercial Code, which had become effective in Oregon,[2] a financing statement executed by the Reporter and Rose City was filed on November 26, 1963. It identified the collateral as "accounts receivable," but did not disclose a claimed security interest in either contract rights or proceeds of the collateral [Ex. 3].

At the end of April 1964, as part of a proposal for further financing by Robert J. Davis, the Reporter was merged into the bankrupt, a new corporation named Portland Newspaper Publishing Co., Inc. [Ex. 19; C. Tr. 4]. While the bankrupt under the merger plan took over the Reporter's assets and agreed to assume the predecessor's liabilities [Ex. 19; R. Tr. 360], it did not enter into a new security agreement with Rose City. Nor did the parties ever execute or file a financing statement relating to the bankrupt's accounts. Rose City continued the practice of permitting the bankrupt to collect and use the receivables arising after the merger free of restriction or accountability [C. Tr. 35].

On September 27, 1964, the board of directors of the bankrupt found that further publication of the paper held no reasonable expectation of profit and resolved to discontinue business on September 30, 1964 [C. Tr. 5]. By a letter dated September 28, 1964, Rose City directed the bankrupt to transmit the cash proceeds collected from its receivables to a named representative

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[2]The Uniform Commercial Code became effective in Oregon on September 1, 1963. Citations to the Code in this Brief are to the section numbers as designated in the official text. These can be converted to the Oregon Revised Statutes citation by changing the dash to a decimal point and expanding the number by adding the digit "7" at the beginning and the digit "0" at the end. Thus, §9-108 of the official text is O.R.S. §79.1080.

of Rose City, DuBay and Davis, all of whom claimed interests in those accounts [Ex. 39; C. Tr. 91].

On October 15, 1964, certain employees of the bankrupt filed an involuntary petition in bankruptcy, and adjudication followed four days later [C. Tr. 6].

From and after September 29, 1964, the creditors' representative collected the accounts receivable of the bankrupt and deposited the proceeds in a special trust account. After bankruptcy, a similar course of collecting was followed under an agreement that the trust account would be held pending determination of the respective rights by the bankruptcy court [Ex. 39].

There is now approximately $107,000 thus held under the agreement [Ex. 27; C. Tr. 6, 90]. The claimants asserting security interests in the fund include Rose City with a claim having a balance due of $53,122.36 plus interest, and DuBay and Davis who each have a claim for $25,000 plus interest [Exs. 15, 16, 17]. Approximately 5% of the fund in question represents collections of accounts in existence on June 15, 1964, the beginning of the four months' period preceding bankruptcy. The remaining 95% is the proceeds of receivables generated during the four months' period [C. Tr. 44]. At all material times, as both courts below found, the bankrupt was insolvent [C. Tr. 12, 94], and Rose City knew or had reasonable cause to know about this financial condition [C. Tr. 19, 95].

After a trial, the Referee in Bankruptcy held the security interests asserted by DuBay and Davis invalid

on various grounds. With respect to Rose City, he ruled the claimed interest preferential under §60 of the Bankruptcy Act, to the extent it attached to the 95% of the accounts coming into existence within four months of the petition as security for antecedent loans made in 1963 [C. Tr. 58-59].

On review, Judge Solomon affirmed as to DuBay and Davis. He held, however, that Rose City had a valid security interest in all respects and reversed the Referee on this aspect of the case [C. Tr. 104, 115].

Statutes Involved.

The various statutes involved are set forth in the Appendix to this Brief.

Specification of Errors.

Appellant contends that (1), Rose City's security interest is invalid under the Uniform Commercial Code itself, for failure of the parties to file a financing statement or to enter into a new security agreement with respect to the bankrupt's accounts receivable; and that (2), under §60 of the Bankruptcy Act, the security interest is preferential in any event to the extent it attached to accounts arising within four months of bankruptcy. It is submitted here that the decision below is erroneous in that it upheld Rose City's security interest and is thus inconsistent with both of the foregoing contentions.

Questions Presented.

1. Whether Rose City's security interest is invalid under the Uniform Commerical Code itself, in view of the failure to file a financing statement or to make a new security agreement relating to secured transactions with the bankrupt, as distinguished from the bankrupt's predecessor corporation.

2. Whether security interests, which attach to accounts receivable as they come into existence within the four months' period preceding bankruptcy, are preferential under §60 of the Bankruptcy Act, when the loans to be secured were made before the beginning of that period.

   Subsidiary questions are:

   a. Whether §9-108 of the Uniform Commercial Code applies in this case; if applicable, does it save otherwise preferential security interests from invalidation under §60 of the Bankruptcy Act.

   b. Whether, despite the attaching of security interests to accounts only as they arise within the four months' period, the transfer can be said to occur more than four months before bankruptcy on a *res* or entity theory of accounts as collateral, or under the perfection test of §60a(2) of the Bankruptcy Act.

   c. Whether, despite the attaching of security interests to accounts within the four months' period, the transfer can be said to be for contemporaneous rather than antecedent consideration on a substitution of collateral theory.

Summary of Argument.

Rose City's security interest in the accounts in question was unperfected under the terms of the Uniform Commercial Code. No financing statement was ever filed with respect to the receivables of the bankrupt, as distinguished from those of the predecessor corporation. Similarly, there was no written security agreement between Rose City and the bankrupt. These deficiencies made Rose City's security interest in the bankrupt's accounts vulnerable to the rights of a levying creditor, and made the security transaction unenforceable even as between the immediate parties. As a result, the trustee in bankruptcy can avoid the security interest not only as a preference, but also under the Code itself and §§70c and 70a of the Bankruptcy Act.

Even assuming full perfection of Rose City's security interest in present and future accounts under the Code, that interest was invalid as a preference under the Bankruptcy Act to the extent it attached to accounts arising within four months of bankruptcy. The loans by Rose City to be secured by after-acquired accounts were made no later than November 1963. Under the express terms of the Code, the security interest cannot attach or arise, and perfection cannot occur, until the debtor has rights in the collateral; he has no such rights in accounts until they come into existence. Thus, as to any accounts generated between June 15 and October 15, 1964, the security interest was transferred to Rose City within the crucial four months' period and with respect to antecedent indebtedness. The other elements of a recoverable preference being present, the trustee can invalidate Rose City's security under §60 of the Bankruptcy Act.

Section 9-108 of the Code cannot save Rose City's security interest for two reasons. The section in essence provides that if a present loan is made to a debtor or new value is otherwise given to him to be secured by after-acquired property, the security interest is deemed to be taken for new value and not for antecedent debt if the debtor acquires the future collateral in the ordinary course of business.

First, the section by its own terms does not apply to Rose City's case. It requires that new value be given at the time of the security agreement, whereas Rose City's advances had been previously made for various operating purposes over a period of time and thus were antecedent, at least in great measure, when the security agreement was made in November 1963.

Secondly, and more fundamentally, §9-108 conflicts with the Bankruptcy Act and is therefore invalid if it is applied so as to make contemporaneous a consideration which otherwise would be antecedent under §60 of the Act. Congress has not left the meaning of antecedent debt to state law. The clear meaning of antecedent debt as used in §60 is that the indebtedness of the bankrupt was incurred prior to the time of the questioned transfer, and this definition involves the federal policy of achieving a fair and equitable distribution of the bankrupt estate. The Chandler Act of 1938 amended the preference section for the purpose of abolishing the relation back doctrine theretofore followed by many states. Under that doctrine, certain defective transfers

were related back or said to have occurred when the parties made their original agreement rather than when the transfer was actually completed or perfected. By fictionally relating the original new value forward to the time the security interest attaches to after-acquired property, §9-108 achieves the same result as the forbidden relating back of the transfer to the time of the giving of new value. Thus, the federal and state laws clearly collide.

Efforts to reconcile §9-108 and §60 on a substitution of collateral doctrine or on some other theory which is consistent with the Bankruptcy Act are unavailing. To the extent such a theory might insulate the Code security interest from attack as a preference, it would do so with or without the existence of §9-108, and the section thus adds nothing to the secured party's case.

Two theories, sometimes referred to as the *res* theory and the lien creditor theory, have been asserted in an attempt to establish that the transfer in question occurred at the point the security agreement was made and the financing statement was filed, rather than at the time the accounts arose. The *res* theory views receivables collateral as a single entity, separate from the individual accounts which compromise it; the transfer of the entire *res,* both present and future components, is said to take place when the agreement is made and the consideration is given. This theory, however, cannot be squared with the Code itself. It disregards the express provisions that a security in-

terest cannot attach to accounts, and perfection cannot occur, until the accounts arise. Moreover, the Code draftsmen would not have needed a §9-108 to relate the new value forward to the time the collateral comes into existence if they had contemplated that the transfer of the entire *res,* including future collateral, took place when the new value was given in the first instance.

Another version of the *res* theory considers future accounts as proceeds of present contract rights or general intangibles. Since the latter can be presently transferred before they mature into accounts, the argument is that the transfer occurs when the collateral in its earlier form is made subject to the security interest. This version of the theory, however, has no application to the present case. For there is no showing in the record that the accounts claimed by Rose City arose under pre-existing contracts, and more importantly, the financing statement did not cover contract rights or general intangibles but only accounts receivable.

In any event the *res* theory could not be reconciled with §60. A theory which asserts that a present transfer of a security interest takes place before the debtor realistically has rights in the collateral suffers from the same vice as the discredited relation back doctrine. Functionally, this kind of transfer is too similar to a mere promise to give security in the future. Independently of the Code, §60 requires that the debtor have rights in the collateral before he can transfer it.

The lien creditor theory is based on §60a(2) of the Act, which provides that a transfer is deemed to be made when it became so far perfected under state law that no subsequent lien by judicial proceedings could become superior to the rights of the transferee. Since, under the Code, a levying creditor could not defeat the secured party's rights in the collateral at any time after the perfection step occurred—*i.e.* the financing statement was filed—the argument is that the transfer of the security interest to Rose City took place in November 1963. One fallacy in the lien creditor theory is that §60a(2) looks to state law—here §9-303(1) of the Code—for the date of perfection as against levying creditors. Regardless of the filing of the financing statement, under the Code such perfection does not occur before the accounts come into existence, even though there might be no instant in time when a judicial lien creditor could defeat the secured party. Moreover, as was also observed in connection with the *res* theory, §60 itself contemplates that a transfer cannot occur until the debtor has rights in the collateral. The function of §60a(2) is to postpone to a later date the time of a defective transfer which actually has taken place. It is not intended to relate backwards in time an actual transfer of the debtor's property merely because the perfection step occurred first.

Nor can Rose City's security interest be sustained on a substitution of collateral rationale. While substitution of collateral of equal value in exchange for a re-

lease of old collateral is non-preferential under §60, this doctrine requires that the replacement of new collateral must precede or be contemporaneous with the release of the old. If the release occurs first, the secured party becomes temporarily unsecured, and even a short delay in replacing the security results in a potential preference under §60. Thus, to bring himself within the substitution doctrine, the secured party must be able to match up replacements and releases to show that they took place at the requisite points in time. Some policing or keeping track of the debtor's use of the collateral seems essential for this purpose. Section 9-205 of the Code, which abolishes the dominion and control rule of *Benedict v. Ratner,* may enable the debtor to use the collateral freely without fraud being imputed as a matter of state law. But it does not, indeed could not, change the conditions which must be shown to exist before the substitution of collateral doctrine will apply under §60.

The present record does not support an application of the substitution doctrine. The only significant evidence bearing on the point is a stipulation entered into after decision by the Referee. This raw data, without more, is insufficient to support a conclusion that a true substitution of collateral occurred insofar as Rose City is concerned.

As a matter of overall §60 policy, Rose City's security interest should be invalidated. This was not the usual commercial financing situation where advances were made on the strength of receivables with the

lender at all times looking to the collateral for liquidation of the loans. The debtor was free to dispose of the collateral as it saw fit. Repayment of the loans was of secondary importance; the primary purpose was to maintain publication of the newspaper. Only when bankruptcy seemed imminent did Rose City look to its security. The policy of §60 forbidding a strengthening of position just before bankruptcy, does not permit a lender to behave like an unsecured creditor until the time of trouble, and then to take a secured stance. It also follows that invalidation of Rose City's security will not adversely affect legitimate financing transactions. Section 60 aside, prudent financiers do police their collateral for a number of business reasons, and this course of conduct, in proper cases, will enable them to meet the preference problem by showing true substitutions of collateral.

Finally, if Rose City's security interest is upheld, the case must be remanded for the purpose of determining, among other things, whether the senior DuBay and Davis interests should be preserved for the benefit of the bankrupt estate, and whether the parties meant Rose City to have any interest in the accounts intended for DuBay and Davis.

ARGUMENT.

I.

INTRODUCTION.

This case has been considered by many commentators to involve the intersection of the Uniform Commercial Code's provisions relating to after-acquired property with the avoiding power of a trustee under §60 of the Bankruptcy Act. These writers assume that Rose City was a creditor with a security interest fully perfected under applicable state law, and proceed to discuss whether the Code, which is deemed to embody and protect contemporary good business practice, can be reconciled with the federal statute. So viewed, one important aspect of the matter is the validity of §9-108 in bankruptcy proceedings.

The major portion of this brief is devoted to the broad issues which have received the attention of the law reviews,[3] but we submit that they are not clearly

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[3]See, *e.g.,* Gordon, Nahum, *The Security Interest In Inventory Under Article 9 of the Uniform Commercial Code and the Preference Problem,* 62 Colum. L. Rev. 49 (1962) *reprinted at* Coogan, Hogan, Vagts, Secured Transactions Under The U.C.C. (1967) (hereafter "Coogan Et Al.") ch. 11; Kennedy, Frank, *The Trustee In Bankruptcy Under The Uniform Commercial Code: Some Problems Suggested by Articles 2 and 9,* 14 Rutgers L. Rev. 518, 539-549 (1960) reprinted at 1 Coogan Et Al., ch. 10, §§10.03[7]-[9] (1967); Riemer, Bernard, *Bankruptcy-Preference Conflict Between §9-108 of the Uniform Commercial Code and §60(a) of the Bankruptcy Act,* 70 Comml. L.J. 63 (1965); Viles, Robert, *The Uniform Commercial Code v. The Bankruptcy Act,* 55 Ky. L. Rev., 636 (1967); Coogan and Bok, *The Impact of Article 9 of the Uniform Commercial Code on the Corporate Indenture,* 69 Yale L.J. 203 (1959) *reprinted and revised* Coogan Et Al., ch. 13; Friedman, Harold, *The Bankruptcy Preference Challenge to After-Acquired Property Clauses Under The Code,* 108 U. Pa. L. Rev. 194 (1959); Henson, Ray, *"Proceeds" Under The Uniform Commercial Code,* 65 Colum. L. Rev. 232 (1965); 3

presented for decision in Rose City's case. Thus, the Bankruptcy Act aside, there is a serious question here as to whether Rose City's security interest was ever perfected under the Code itself, and, indeed, whether there even existed an enforceable security agreement under state law. Again, there is doubt as to whether §9-108 of the Code is, on its own terms, applicable to the case at hand. In any event, the relationship between Rose City and its borrower was not typical of commercial financing transactions nor could it be considered "good business practice."

II.

ANY SECURITY INTEREST OF ROSE CITY IN THE ACCOUNTS OF THE BANKRUPT WAS UNPERFECTED AGAINST THE TRUSTEE IN BANKRUPTCY UNDER THE CODE ITSELF.

While a security interest may be valid as between the immediate parties as soon as it arises, the Uniform Commercial Code requires a perfection step as a condition of validity as to third persons, including levying creditors and trustees in bankruptcy. §9-301. Perfection of a security interest in the accounts of a debtor is accomplished by the filing of a financing statement. §9-302. The financing statement may be a simple document, but there are some minimum requirements. Among the things it must contain are the signature of the debtor and a description of the collateral. §9-402.

Although a financing statement was filed covering transactions between Rose City and the bankrupt's

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Collier on Bankruptcy ¶60.51A (6th Ed. 1964); Gilmore, Security Interests in Personal Property chs. 8, 45 (1965); see also authorities collected at Viles, *supra*, nn 1-16.

predecessor, Portland Reporter Publishing Co., Inc., [Ex. 3], none was signed by nor filed with respect to the bankrupt, Portland Newspaper Publishing Co., Inc. True, the bankrupt acquired its predecessor's assets and liabilities in a merger [Ex. 19; R. Tr. 360], but both before and after the merger it was a distinct legal entity. At all times, the bankrupt bore a differferent name, was controlled by different shareholders, and had different corporate officers.[4] In short, during the course of its financing the publication of the newspaper, Rose City dealt with two separate and distinct "debtors." §9-105(d).

Yet only one financing statement was ever filed. Possibly, the financing statement filed with respect to Portland Reporter Publishing Co., Inc. served to protect Rose City's security interest in the accounts of that predecessor corporation which were transferred to the bankrupt in the merger.[5] But substantially all the accounts and proceeds in question arose after the

[4]Under the terms of the merger, each share of the outstanding stock in the Reporter was exchanged for Class A, nonvoting shares in the bankrupt. On the other hand, Robert J. Davis and certain others received Class C, voting stock of the bankrupt [Ex. 19; R. Tr. 360]. Thus, as a result of the merger, control of the newspaper passed from the previous stockholders of the Reporter to the bankrupt's Davis group. Robert E. Webb, President of the Reporter and a member of its Board of Directors, became the assistant publisher of the bankrupt corporation, but was not a member of its board. Robert J. Davis was President and publisher of the bankrupt, but had not been an officer of the Reporter [R. Tr. 183-184].

[5]*Cf.* §9-306(2). *But see* Advanced Ali-Aba Course of Study on Banking and Secured Transactions Under the Uniform Commercial Code, *Course of Study Transcript 2* at 186-230 (1968), in which it is suggested that if a secured creditor consents to a transfer of his collateral to a new entity, he is under a duty to re-file as to the new debtor. It he fails to do so, he loses his security in the collateral so transferred.

merger [C. Tr. 44; Ex. 27]. These are the bankrupt's accounts; they never belonged to the predecessor corporation. The debtor whose collateral is now sought by Rose City was not named on the public record. See §9-105(d). The inescapable result is that the security interest in the bankrupt's accounts was at all times unperfected under the Code.

The failure to obtain and file a new financing statement in Rose City's case is not a mere technical or harmless oversight which may be excused or overlooked. The purpose of the filing requirement is to give notice to the world, or at least to any interested party who cares to examine the public records, of the existence or possible existence of security transactions. §9-402, Comment 2. A search of the record for security interests in the bankrupt's accounts would not have indicated any claim in favor of Rose City. To excuse the failure to file the financing statement, therefore, would be to frustrate an underlying policy of the Code itself.

Since Rose City's claim to the accounts of the bankrupt was unperfected under the Code, and was thus subject to the rights of levying creditors, §9-301(1)(b), (3), the security interest in any accounts remaining uncollected at bankruptcy was clearly preferential under §60 of the Bankruptcy Act. As will be more fully discussed in part III of this Brief, a transfer unperfected at the date of bankruptcy is, for the purpose of the preference section, deemed to have been made immediately before the filing of the petition.

Moreover, regardless of §60, the trustee's strong-arm or ideal lien creditor's rights under §70c of the Act

enable him to invalidate any security interest which remains unperfected on the date of bankruptcy. See also UCC 9-301(1)(b), (3).

The failure to file a financing statement has a similar result with respect to the proceeds of accounts actually collected on behalf of Rose City between September 29, 1964 and the date of the petition. As to these sums, the security interest may have become perfected by possession, but such perfection shortly before bankruptcy fixes the effective date of the transfer at this point, and brings it well within the four months' period for the purpose of §60. See part III of this Brief *infra.*

Up to now we have assumed that the security interest was binding under the Code as between the immediate parties. However, it can be argued forcefully that Rose City's claim lacked enforceability even as to the bankrupt. For a non-possessory security interest to be enforceable against the debtor, §9-203(1) requires that he sign a written security agreement which contains a description of the collateral. While the bankrupt generally assumed its predecessor's liabilities in the merger, it did not enter into new written security agreements with the various lenders. We submit that the contract between Rose City and the bankrupt's predecessor cannot serve the requirement of §9-203(1). It was not signed by the bankrupt, nor did it purport to convey a security interest in the bankrupt's accounts as distinguished from the predecessor corporation's accounts. The security interest in the accounts in question is thus unenforceable against the trustee by virtue of his standing in the position of the bankrupt under §§70a and 70c of the Bankruptcy Act.

III.

ASSUMING PERFECTION UNDER THE CODE, ROSE CITY'S SECURITY INTEREST IN ANY ACCOUNTS ARISING WITHIN FOUR MONTHS OF BANKRUPTCY IS INVALID AS A PERFERENCE.

A. All the Elements of a Voidable Preference Are Present.

We may assume for this argument that Rose City's security interest was properly perfected and fully enforceable under applicable state law, the Uniform Commercial Code as in effect in Oregon. Nevertheless it remains to be tested by the provisions of §60 of the Bankruptcy Act. This portion of Appellant's Brief will demonstrate that the security interest is a voidable preference to the extent it reaches accounts which came into existence within four months of bankruptcy.

A preference, as defined in §60a, consists of six elements: (1) a transfer of the debtor's property (2) to or for the benefit of a creditor (3) made while insolvent (4) within four months before bankruptcy (5) for an antecedent indebtedness (6) the effect of which is to enable that creditor to obtain a greater percentage of his claim than other creditors of the same class. The trustee can recover or avoid such preference under §60b if a seventh element is present, that is, if the creditor at the time of the transfer had reasonable cause to believe that the bankrupt was then insolvent.

Clearly the bankrupt's granting a security interest in its accounts was a "transfer" of its property within the meaning of the first element of a preference, §1(30), and Rose City was a creditor for the purpose of the second, §1(11). The factual elements of insolvency and reasonable cause to believe were found by both courts

below [C. Tr. 12, 18, 94-95]. The only serious questions relate to the time of the transfer and whether it was for antecedent indebtedness, that is, the fourth and fifth elements.[6] These will determine the existence of the sixth element as well.[7]

In connection with determining the time of a transfer, §60a(2) of the Act should be mentioned. If, under applicable state law, a transfer is not perfected when it is made as against a judicial lien or levying creditor, the date of the transfer is deemed to be the time it becomes so perfected. *Cf.* §60a(7). Or, if perfection has not occurred at all by the date of bankruptcy, the transfer is deemed to take place immediately before the filing of the petition.

Turning to the Code, it is abundantly clear that Article 9 does not contemplate the passage of any security interest in a given account, let alone a perfected one, until such time as the account actually arises or comes into existence. Section 9-204(3) does contemplate that a security interest may be granted in after-acquired property, *i.e.,* collateral acquired by the debtor after the

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[6]The substitution of collateral argument discussed in part III D of this Brief *infra* may be thought of as raising a question as to the existence of the sixth as well as the fifth element. *But see* note 7.

[7]A finding that the transfer was for an antecedent debt means that the creditor was unsecured at the time of the transfer and therefore in the same class as the other creditors of the estate. On the other hand, where the creditor is secured at the time of the transfer, the release of the security provides present consideration for the transfer. *Cf.* Seligson, *The Code And The Bankruptcy Act: Three Views on Preferences And After Acquired Property,* 42 N.Y.U.L. Rev. 278, 294 (1967).

making of the agreement. But §9-204(1) provides that the interest "attaches" to the collateral—that is, it arises or is created—when the *last* of the following events has occurred: First, the parties must agree that the security interest attach; second, value must be given; and third, the debtor must have rights in the collateral. Section 9-204(2)(d) expressly provides that a debtor has no rights in an account until it comes into existence. Furthermore, if the perfection step such as the filing of the financing statement has occurred previously, perfection takes place when the security interest attaches, and not at the earlier point of filing. §9-303(1).

When these Code provisions are related to the elements of a preference, it becomes plain that Rose City's security interest in the after-acquired accounts of the bankrupt is preferential to the extent that it attached to accounts coming into existence within the four months preceding bankruptcy. The transfer occurred not when the parties signed the security agreement and filed the financing statement in November 1963 [C. Tr. 44], but only as the accounts actually arose between June 15, and October 15, 1964. On the other hand, the loans secured by those accounts were made by Rose City no later than November 1963 [Ex. 17; C. Tr. 95; See discussion at Part III B1 of this Brief, *infra*]. The elements involving the four months' period and the antecedent indebtedness thus are demonstrably present.

B. Despite Section 9-108, the Transfer to Rose City of a Security Interest in the Debtor's Collateral Was for an Antecedent Debt.

The draftsmen of the Code did not overlook the potentially preferential nature of a security interest in after-acquired property. Their effort to overcome the problem is §9-108:

> "*When after-acquired collateral not security for antecedent debt.* Where a secured party makes an advance, incurs an obligation, releases a perfected security interest, or otherwise gives new value which is to be secured in whole or in part by after-acquired property his security interest in the after-acquired collateral shall be deemed to be taken for new value and not as security for an antecedent debt if the debtor acquires his rights in such collateral either in the ordinary course of his business or under a contract of purchase made pursuant to the security agreement within a reasonable time after new value is given."

Judge Solomon believed that this provision saved Rose City's security interest, relying to a considerable extent on a similar ruling in *Rosenberg v. Rudnick*, 262 F. Supp. 635 (D.Mass. 1967). We submit that reliance on §9-108 was erroneous; first, because it is inapplicable to Rose City's loans by its own terms, and second, because the attempted application conflicts with §60 of the Bankruptcy Act.

1. Section 9-108 Is Inapplicable by Its Own Terms.

Section 9-108 on its face does not apply unless the security interest in the after-acquired collateral is granted at the time the creditor "makes an advance, incurs an obligation, releases a perfected security in-

terest, or otherwise gives *new value . . .*" While the term "new value" is not defined in the Code, it, like much of Article 9, derives from the Uniform Trust Receipts Act. §9-402, comment 2. Under that former law, "new value" was defined so as to expressly exclude "extensions or renewals of existing obligations . . . [and] obligations substituted for such existing obligations." Uniform Trust Receipts Act, §1(c); O.R.S. §73.010(7) (repealed 1963).

The security interest granted to Rose City in after-acquired accounts was not given for "new value." The security agreement upon which Rose City relies was made November 22, 1963 [Ex. 17]. Yet of the total principal obligation of $53,122.26 owing to this creditor at bankruptcy, at most the sum of $10,300 was loaned on the day of the agreement. Even on the facts as stated by Judge Solomon, the remaining $42,822.26 represents the unpaid balance of a loan made about one week earlier on November 16, 1963 [C. Tr. 95]. In reality, however, the record leaves no doubt that to a large extent the two notes dated November 16 and 22 represent a consolidation of several previous advances made on an emergency basis over a period of time to meet payrolls, taxes and other expenses.[8] Thus, the agreement of November 22, 1963 was an attempt to secure Rose City on what was then, at least in great measure, unsecured, antecedent indebtedness. The new value requirement of §9-108 simply did not exist.

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[8]The controller of the Reporter testified that the two notes of November 16 and 22, 1963 represented consolidations of the unpaid balances of advances made by Rose City over an extended period of time between March 2, 1962 and November 5, 1963 [R. Tr. 28]. But *cf.* the testimony of the President of appellee [R. Tr. 236-237].

2. The Attempted Application of Section 9-108 Conflicts With Section 60 of the Bankruptcy Act.

Even if §9-108 does apply, the validity of the section is immediately suspect because it is aimed directly at the Bankruptcy Act. Although the Official Comments state that the section "is of importance principally in insolvency proceedings under the federal Bankruptcy Act or state statutes which make certain transfers for antecedent debt voidable as preferences," it is hard to escape the conclusion that §9-108 was designed solely with §60 in mind. *E.g.,* Gordon as reprinted in Coogan et al., note 3 *supra* at 1172-1177. Recognizing the supremacy of federal law, partisans of the Code strive to demonstrate a consistency between the two statutes, and the District Judge below was so persuaded.

One argument that is made, although Judge Solomon apparently did not directly accept it, is that because the Bankruptcy Act fails to define antecedent debt, the term is left for permissible definition by the states. §9-108, Comment 1. This position is fallacious. The clear meaning of antecedent debt as used in §60 is that the indebtedness of the bankrupt was incurred prior to the time of the questioned transfer. The only element of a preference for which §60 looks in part to state law is the time of the transfer—the date on which it became perfected as against levying creditors, if that date is subsequent to the actual transfer. *E.g.*, 3 Collier on Bankruptcy, §60.39 at 960 (14th Ed. Moore 1967). If the debt was incurred before the time of the transfer as so determined, it is antecedent as a federal matter. That the preference statute has its own notion of what is antecedent clearly appears in §60a(7), permitting a limited relation back under special circumstances.

E.g., Kennedy, Note 3 *supra,* at 542-543, 547 n. 125. It has been shown earlier that the transfer of after-acquired accounts occurs under the Code when they come into existence. A loan made before the accounts arise is factually not new value, and any attempt of §9-108 to make it fictionally so is ineffective as beyond the power of state law. 3 Collier on Bankruptcy, ¶60.51A at 1050.16-1050.17 (14th Ed. Moore 1967).

Judge Solomon seems to say that while the definition of antecedent debt is a matter of federal law, that law should be determined with reference to "good business practice"; that since leading scholars and businessmen participated in drafting and sponsoring §9-108, and nearly all American jurisdictions have enacted it, the section truly is a guide to the federal meaning of antecedent debt. We believe such reasoning is unpersuasive. It implies that before the Code was widely accepted a loan to be secured by after-acquired collateral was an antecedent debt when the collateral came into existence, but after the Code it is not. And this change occurred without action by Congress, and with respect to an element of §60 not left to state law.

Far from generally accepting state policy in the determination of the elements of a preference, the 1938 Chandler Act version of §60, as refined in the amendments of 1950, rejected the then current state policy. A primary purpose of the 1938 amendments to §60 was to defeat the so-called equitable lien and the doctrine of relation back *e.g.,* 3 Collier on Bankruptcy, ¶60.50 (14th Ed. Moore 1967), no matter how many states or businessmen recognized them. *Cf. Corn Exchange National Bank & Trust Co. v. Klauder,* 318 U.S. 434, 437-438, 63 S. Ct. 479 (1943).

One of the decisions the Chandler Act intended to reverse was *Sexton v. Kessler,* 225 U.S. 90, 25 S. Ct. 306 (1912). *Cf.* H. R. Rep. No. 1293, 81st Cong., 1st Sess. 6 (1949). The bankrupt, a New York brokerage firm, had agreed to set aside certain securities as collateral for amounts it might owe one of its creditors from time to time. The securities were segregated in the bankrupt's vault, specially marked with the creditor's name in an escrow package. On occasion, the bankrupt would substitute new securities for the ones originally placed in the escrow, but all substitutions were entered in the records. Several years later, the bankrupt's condition being shaky, the creditor demanded and obtained possession of the escrow securities, and bankruptcy followed shortly thereafter. The Supreme Court held the transfer non-preferential, reasoning that despite the delivery of possession on the eve of bankruptcy, the creditor's rights or equitable lien in the collateral dated under New York law from the original agreement; the transfer was thus outside the four-months period.

As noted, §60 was amended by the Chandler Act to nullify this state law concept of a transfer's relating back to a date earlier than it had actually occurred. In form, §9-108 of the Code relates the original consideration or a new value forward to the date the security interest attaches to after-acquired property. It says, as applied to Rose City's claim, that loans made no later than November, 1963 are new value for security interests attaching to accounts as they arise after June 15, 1964. Is this not the same as relating the attachment of the security interest back to the giving of new value? The result cannot be reconciled with §60's purpose as it has existed since at least 1938.

Judge Solomon's conclusion that a reconciliation was possible apparently was influenced by several other arguments. He referred to the fact that the Code's security interest in after-acquired collateral is not a secret lien because of the filing requirement. Secret liens, however, are only one of the things that the Chandler Act denounced. The equitable lien in *Sexton v. Kessler* was not a concealed one. The pledged securities there were segregated and marked, and anyone examining the bankrupt's vault could have determined the creditor's interest. Similarly, the 1938 amendments intended to reverse cases such as *Thompson v. Fairbanks,* 196 U.S. 516, 63 S. Ct. 682 (1905), involving the perfection within the four-months period of a mortgage of after-acquired property, although the mortgage was recorded. *E.g.,* Hearings on H. R. 6439 Before House Committee On The Judiciary, 75th Cong., 1st Sess. 120-125 (1937); McLaughlin, *Aspects Of The Chandler Act Bill To Amend The Bankruptcy Act,* 4 U. of Chi.L.Rev. 369, 393 (1937). There was no vice of secrecy in the lien on after-acquired collateral involved in *Eberly v. Dudley,* 314 F. 2d 8 (9th Cir. 1963), which this Court invalidated under the 1950 amendments to §60 despite recordation of the mortgage. *Cf. Corn Exchange National Bank & Trust Co. v. Klauder,* 318 U.S. 434, 63 S. Ct. 479 (1943) (involving an assignment of accounts receivable under supervision of a creditors' committee). *See also* Kennedy, note 3 *supra* at 543, n. 107. We submit that §9-108 cannot survive merely on the ground that a Code security interest does not involve secrecy.

Judge Solomon also observed that §9-108 applies only if the debtor acquires the collateral in the ordinary

course of business, from which he reasoned that it did not permit the secured party to improve his position as against other creditors during the crucial period before bankruptcy. Thus, the section could be reconciled with federal policy, for it merely embodies a substitution of collateral doctrine. We submit again that there is fallacy here. Section 9-108 clearly is not limited to situations where there is a true substitution of collateral, as this example shows: About four months before bankruptcy, the debtor borrows $50,000 on the security of all his present and future accounts receivable. If, because of the seasonal nature of the business or otherwise, the balance of existing accounts is low, the creditor is virtually unsecured at the time of the loan. During the next four months, the debtor fills his customers' orders in the ordinary course of business, so that at bankruptcy—just before Christmas, when the bulk of the inventory has been shipped—the accounts receivable aggregate $50,000 or more. Section 9-108, if applied, would validate the attaching of the security interest to the accounts as being for new value.

What has happened, however, is that inventory and other assets available to all creditors ratably have been converted within four months of bankruptcy into a type of asset which is subject to a special claim of the secured party. Yet realistically he was only a general creditor at the time he made the loan. With all deference to Judge Solomon, this is an improvement of position which §60 plainly would not permit. The or-

dinary course of business requirement of §9-108 may prevent its use to effect bad faith preferences, but §60 also prohibits those preferential transfers which are made as a matter of routine and with completely good intentions.

As is discussed below, a true substitution of collateral of equal value is not preferential within the meaning of §60, since such an exchange of collateral involves present consideration rather than antecedent debt. To the extent that §9-108 merely embodies this principle it can be squared with federal law. On the other hand, to the extent §9-108 characterizes as new value something that otherwise would be antecedent under §60, the statutes collide.

We will discuss in the next portion of this Brief two further theories adverted to by Judge Solomon in reconciling §9-108 with the Bankruptcy Act. Basically, both assert that Rose City's security interest involved a transfer which occurred more than four months before bankruptcy. To the extent of their validity and relevance to §9-108, the theories make it possible to avoid a conflict with §60. But the point is this: §9-108 cannot stand on its own and it adds nothing to the secured party's case. *E.g.*, Friedman, note 3 *supra* at 215, 219-220; Seligson, note 7 *supra* at 298. Its validity must depend on the development of some theory which independently can insulate the security interest from the preference section.

C. Notwithstanding the "Res" and "Lien Creditor" Theories, the Transfer to Rose City of a Security Interest in the Debtor's Accounts Occurred Within Four Months of Bankruptcy.

1. The Res Theory.

What has variously been called the "res", "entity", or "Mississippi River" theory conceives of receivables or inventory collateral as a single entity, separate and distinct from their component items—just as the Mississippi River is an entity distinct from the drops of water within its banks at any given moment. From this premise it is argued that the debtor has at all times a present interest in the totality of his inventory and receivables, including the future as well as existing components, so that the creation of a security interest in all the collateral really occurs at the time the security agreement is made and value is given. *E.g.,* Friedman and Henson, note 3 *supra; cf. Manchester National Bank v. Roche,* 186 F. 2d 827 (1st Cir. 1951). Thus viewed, the transfer to Rose City of a security interest in the debtor's future accounts took place in November 1963, well before the four months' period began.

We submit that Article 9 does not adopt this *res* theory, nor is §60 consistent with it. Concededly, one feature of the theory is present in the Code, namely, the rule that a security interest will automatically attach to after-acquired collateral as it comes into existence without the necessity for any further steps.[9]

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[9]Section 9-303(1). In this respect, the Code significantly changed the prior law in many states. Under pre-Code law, possession or some other affirmative step was frequently required to perfect a chattel mortgagee's lien on after-acquired property. *E.g.,* Friedman, note 3 *supra,* at 199; Riemer, note 3 *supra* at 65.

But this is not a sufficient basis for the conclusion contended for by the theory's proponents. We cannot disregard §§9-204(1) and 9-204(2)(d) which expressly provide that the security interest does not attach until the debtor has rights in the collateral and that a debtor has no rights in accounts until they arise. Indeed, the Official Comments to §9-204 seem to expressly reject the concept of a transfer of a *res* at an earlier point:

> "A security agreement may be executed and value given before the debtor acquires rights: the security interest will then attach under subsection (1), as to after-acquired property, when he does." Comment 4.

Moreover, if the drafters of Article 9 had contemplated an earlier transfer of the *res,* there would have been no need for §9-108.[10] The function of this provision is to relate the consideration forward in time to the point when, contrary to the *res* theory, the drafters conceived the security interest in after-acquired property would pass to the secured party.[11]

We now turn to a somewhat more sophisticated version of the *res* theory which views the secured party

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[10]*Cf.* Mr. Friedman's suggestion that §9-108 be amended to provide that upon the conditions now stated the security interest "shall be deemed a present transfer of a present expectancy interest in the future property of the debtor. . . ." Friedman, note 3 *supra,* at 224.

[11]It might be noted in passing that advocates of the *res* concept do not seem to urge it with respect to collateral other than receivables and inventory. But if it is valid at all, there appears to be no sound reason why fixed assets such as machinery and office equipment should not also be considered as entities. Certainly it would be apparent that a creditor with a security interest in equipment, who makes no new advances and who releases no collateral, receives a preference to the extent the debtor buys new machinery within the four-month period.

as having a continuously perfected security interest in after-acquired accounts as the proceeds of a previous interest in contract rights or general intangibles. An "account" as defined in Article 9 represents a receivable which has been earned; it is a right to payment for goods sold or leased or services rendered, not evidenced by an instrument or chattel paper. §9-106(1). A "contract right" means a right to payment under a contract not yet earned by performance. §9-106(2). If the contract is one for goods or services, the contract right ripens into an account as soon as performance takes place. A debtor has a present interest in a contract right as collateral when the contract is made, §9-204(2)(c), so that it can be transferred at this point despite the fact that it will not mature until later. The perfected security interest then shifts onto the account which arises as proceeds of the contract right. §9-306(1). Thus, §9-204(1)'s requirement that the debtor have "rights in the collateral" is said to be met when the security agreement is made, for it refers not to the point in time when the receivable is earned and becomes an account, but rather to the time when the debtor acquired rights in the collateral in its earlier form as a contract right. *E.g.*, COOGAN AND BOK as reprinted in COOGAN ET AL., note 3 *supra*, at 1398. Taking one more step, perhaps, the debtor's business as a going concern can be considered a "general intangible," the catch-all category of collateral. §9-106(3). The result is that the debtor could create a present security interest in this type of collateral even before the contract right came into existence. The *res* thus becomes all encompassing. See II GILMORE, note 3 *supra*, at 1306-7.

Whatever merits this more sophisticated *res* theory may have as a matter of Code interpretation, it cannot serve to save Rose City's security interest. In the first place, the record does not show that the accounts in which Rose City claims a security interest arose under pre-existing contracts. There is some basis for the argument that a binding contract embodying mutual obligations, albeit executory on both sides, is enough of an existing asset to be the subject of a present transfer. But certainly the case is different if there is no underlying enforceable contract, and the future account is merely an expectancy until it is earned.

Secondly, although Rose City's security agreement with the bankrupt's predecessor covered contract rights as well as accounts, it did not purport to cover general intangibles [Ex. 17]. More importantly, the financing statement described the collateral merely as "accounts receivable." [Ex. 3].[12] It goes beyond charitable construction to suggest, as one of the briefs did below, that this designation on the public record might include contract rights (or general intangibles if the deficiency in the security agreement itself is ignored). Until the accounts actually arose, any conceivable security interest in contract rights or general intangibles as a *res* remained unperfected and subject to levy. Therefore the only transfer upon which Rose City can rely occurred within the four months' period.

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[12]Recognizing that §9-204 clearly sets forth the point of time at which the debtor's hypothesized present interest in future receivables becomes "accounts," even the strongest proponents of the theory do not suggest that a perfected security interest in "accounts" would be sufficient to cover what is viewed as the debtor's present interest in a "general intangible." II Gilmore, note 3 *supra,* at 1305-1307.

But regardless of its validity under the Code or its applicability to the present case, there is a more fundamental infirmity in the *res* theory, namely, that it cannot be reconciled with §60 of the Bankruptcy Act. The first element of a preference requires that there be a transfer of the debtor's property. The difficulty with the *res* theory in this connection involves the notion of what is "property." Absent conflict with the Act, state law may well be relevant to the question. But to achieve its policy of a fair and equitable distribution of the bankrupt's estate,[13] §60, just like certain other sections of the Act, must embody its own basic concept of property. *Cf., e.g., Segal v. Rochelle,* 382 U.S. 375, 86 S. Ct. 511 (1966); *Local Loan Co. v. Hunt,* 292 U.S. 234, 54 S. Ct. 695 (1934); *Chicago Board of Trade v. Johnson,* 264 U.S. 1, 44 S. Ct. 232 (1924). Were this not the case, a state could defeat entirely the goal of §60 merely by redefining what it considers to be "property."

An example may help to illustrate the point: A lender is persuaded to finance a debtor who is first beginning his business. At the outset there are no existing assets, although the debtor may have binding contracts to supply certain customers. The lender advances cash of $10,000, taking a security interest in all of the inventory and receivables which will be generated in the future. Sophisticated theories aside, the lender is truly unsecured as a practical matter at the time of the loan. Bankruptcy ensues four months later at which time the debtor has inventory and accounts receivable of $10,000. Even if state law recognized and

[13]See 3 Collier on Bankruptcy, ¶¶ 60.01, 60.06 (14th Ed. Moore 1967).

enforced a present property interest in future inventory and receivables which could be fully transferred at the time the loan was made, we submit that §60 would defeat the lender. Both its language and spirit would plainly require a ratable distribution of the available assets among all the creditors.

When applied to the foregoing hypothetical case, it is clear that a theory that asserts a debtor has presently transferred property which as a practical matter is not yet in existence suffers from the same vice as the relation back doctrine abolished by the Chandler amendments. In effect it would insulate an otherwise preferential transaction by relating back the realistic time of the transfer to the date the parties agreed that it should occur. This kind of "transfer of property" is too similar functionally to a mere promise to give security in the future to avoid the impact of the present preference section. Thus, §60, like the Uniform Commercial Code but also independently of it, would seem to require that the debtor have rights in the collateral before the transfer can take place.

To some extent, *Rockmore v. Lehman,* 129 F. 2d 892 (2nd Cir. 1942) reversing 128 F. 2d 564, is arguably inconsistent with what has just been said. There the Second Circuit upheld as against a preference challenge a secured party's rights in monies earned within four months of bankruptcy, where the underlying contract had been assigned outside the crucial period. The court relied on applicable New York law which recognized a present assignment of existing but unmatured contract rights. As has been seen, the present case does not necessitate a reconsideration of *Rockmore v. Lehman,* for Rose City never had a perfected security

interest in contract rights under the Code, if indeed such rights even existed. On a proper record, however, we submit that the Second Circuit's decision is questionable. It focused only on the assignment of the contract as the transfer at issue. It did not consider whether transfers occurred for the benefit of the assignee-creditor when, during the four months' period, the debtor made the assigned right more valuable by delivering merchandise or rendering services to the other party to the contract. Finally, the opinion did not deal with whether the broad *res* theory for which it is cited is compatible with the policy of §60.

2. The Lien Creditor Theory.

Like the *res* theory, the lien creditor theory asserts that the transfer of after-acquired collateral occurs at the time the parties make their security agreement and file a financing statement. Here, however, the rationale is that the filing of the financing statement operates to insulate the security interest in the collateral from attack by any subsequent levying creditor, and thus the requirements of §60a(2) have been met. At this point in time, the transfer, in the language of the section, is "so far perfected that no subsequent lien upon property by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee." *E.g.,* King, Lawrence, *§9-108 of the Uniform Commercial Code: Does It Insulate the Security Interest From Attack by a Trustee in Bankruptcy?* 114 U.Pa. L.Rev. 1117, 1131-1133 (1966). Another way of putting it is that from the time of filing, the secured party has a fully perfected "legal" lien on all of the after-acquired property not yet in existence. *E.g.,* Friedman, note 3 *supra,* at 199-200, 215.

Judge Ford in *Rosenberg v. Rudnick,* 262 F. Supp. 635 (D. Mass. 1967), adopted this theory as one of the grounds for his decision. While it is not as clear, Judge Solomon also may have been influenced by this view.

Judge Ford distinguished between perfection under the Code, which, as discussed above, cannot occur before the security interest attaches, §9-303(1), and perfection as against a judicial lien creditor under §60a(2) for the purpose of a preference. This distinction, however, seems questionable. We submit that to the extent it is applicable at all, §60a(2) looks to state law—here §9-303(1)—for the time of perfection as to levying creditors; that, accordingly, a Code security interest cannot be perfected for preference purposes until it arises, though there may be no instant in time when a levying creditor could defeat the secured party.

More fundamentally, the lien creditor theory involves the same fallacy as was pointed out with respect to the *res* theory. Section 60 embodies its own minimum concept of "property." Regardless of state law, the time of the transfer of a security interest cannot occur before the debtor acquires rights in the property. The sole function of the lien creditor test of §60a(2) is to postpone to a later date the time of a defective transfer which actually had already taken place.[14] It

[14]As stated by Professor Kripke: "The Bankruptcy Act, even though it does not expressly state a concept of rights in the property as a prerequisite of the lien creditor test of §60a, obviously must apply such a concept. There cannot be perfection until the debtor has rights in the property, and the bankruptcy test operates only to postpone the perfection after that date." Krause, Kripke and Seligson, *The Code And The Bankruptcy Act: Three Views On After-Acquired Property,* 42 N.Y.U.L.R. 278, 289-290 (1967); *see also* Gordon *reprinted* in Coogan Et Al., note 3 *supra*, at §11.08, pp. 1188-1191; Seligson, *The Newspaper Publishing Case,* 42 REF. J. 5, 8 (1968).

is not intended, as Judge Ford applied it, to relate backwards in time an actual transfer of the debtor's property merely because the perfection step occurred first.

This is especially clear in the case of a preference by way of outright transfer of a debtor's property which was never reachable by judicial process. If a debtor paid an unsecured creditor just before bankruptcy by assigning a receivable at the very moment it became owing, or by transferring a nonexempt asset which is not subject to levy under state law, no lien by judicial proceedings could ever have reached the subject of the transfer, but the transaction would nevertheless be potentially preferential. In both of these cases, it would be said that since no further perfection step was required, the transfer occurred under §60a (1) when it took place in fact, and any inquiry under §60a(2) as to the rights of a lien creditor would be irrelevant.

D. The Transfer to Rose City Cannot Be Sustained on a Substitution of Collateral Theory.

Where a secured creditor releases valid collateral in a contemporaneous exchange for new collateral of equal value, there is no preference even though the substitution takes place within the four months' period. 3 Colοier on Bankruptcy, Paragraph 60.21 (14th Ed. Moore 1967). The result is sometimes explained on the ground that in such a transaction no diminution of the bankrupt estate occurs. In terms of the statutory elements of a preference discussed above, it can be said that this kind of substitution does not involve an antecedent debt, that is, the release of old

security is contemporaneous consideration for the new collateral; or, that under these circumstances the transfer of the new collateral to a secured party is not made to a creditor of the same class as others. On the other hand, if the substituted new collateral is more valuable than the old, or if the security interest in the old collateral was for some reason invalid as to creditors or the trustee, or if the debtor had dissipated or disposed of the old collateral before it is replaced by new security, then the substitution is preferential. *Ibid.* In these cases, the alleged consideration provided by the release of collateral is illusory.

We submit that Judge Solomon's application of the substitution of collateral theory to sustain Rose City's security interest in the after-acquired accounts was erroneous for several reasons.

In the first place, he seems to have taken the four months' period as a unit, comparing the aggregate of the new or substituted accounts with an aggregate of the releases or collections by the debtor. This is an improper approach, for each new transfer must be matched against a contemporarneous or subsequent release. *Cf. Cooper Petroleum Company v. Hart,* 379 F. 2d 777, 780-782 (5th Cir. 1967). Assume, for example, that four months before bankruptcy a creditor is secured by $50,000 of accounts. If the debtor, rightfully or wrongfully, disposes of the collateral or dissipates the proceeds, thus making the creditor temporarily unsecured, a subsequent replacement of $50,000 of new accounts will be preferential, despite the fact that during the period considered as a whole the collateral released and that substituted are equivalent. *Cf. Wolfe v. Bank of Anderson,* 238 Fed. 343 (4th

Cir. 1916). Whether a particular transfer results in the diminution of the estate must be tested on an individual basis.

In re Pusey, Maynes, Breish Co., 122 F. 2d 606 (3rd Cir. 1941), was relied upon in the opinion below as justifying an application of the substitution of collateral principle. The facts of that case, however, make it distinguishable from the present one. The debtor had assigned receivables to a bank as security for a loan, under an agreement requiring the debtor to deposit collections in a special account subject to the bank's control. As the debtor assigned new accounts satisfactory to the bank, the latter released to the debtor equivalent sums from the special deposit. The Third Circuit rejected the trustee's argument that the assignment of new accounts within the four months' period was preferential. It pointed out that the releases of collateral from the special deposit coincided with or occurred after the transfer of new accounts. That is, the bank's security was not allowed to dissipate and the claim did not become unsecured before the collateral was replaced.

The *Pusey* opinion specifically distinguished the situation present in Rose City's case. Here no control was maintained over the collections by the debtor. At the beginning of the period Rose City had a security interest in accounts then existing. With minor exception, all this collateral was collected and used by the debtor or became uncollectible before bankruptcy. The non-preferential security interest thus was lost no later than the moment the proceeds were commingled in the debtor's general bank account and became unidentifiable. *Cf.* §§9-306(2), (4). The subsequent arising of

new accounts accordingly became preferential. It should go without saying that later release of any such preferential accounts, being invalid as to the trustee, could not provide a basis for further application of the substitution of collateral doctrine. 3 COLLIER ON BANKRUPTCY, ¶60.21.

The argument that a financing arrangement such as Rose City's is similar to the *Pusey* situation is based on the fact that the Code abolishes the dominion and control rule of *Benedict v. Ratner,* 268 U.S. 353, 45 S. Ct. 566 (1925). *E.g.,* II GILMORE, note 3 *supra* at 1315-1316; Kripke, note 14 *supra* at 287-288. In that case, the bankrupt had assigned its present and future accounts receivable as security for a loan but was permitted to collect and use the proceeds in the operation of its business. Until the lender made demand, there was no requirement that the bankrupt account for or apply the proceeds to repayment of the secured obligation. The Supreme Court, as a matter of applicable New York law, held the arrangement fraudulent; a debtor could not validly make a transfer or create a lien while retaining dominion or control over the property transferred.

Section 9-205 of the Code changes this doctrine. It can do so without conflict with the Bankruptcy Act because *Benedict v. Ratner* involved an interpretation of state law. It is further true, as *Pusey* holds, that by carefully policing the collateral, releasing old accounts or the proceeds only as new receivables come into existence and are substituted, the preference problem can be avoided. Judge Solomon took the further step of concluding that the abolition of the dominion and control rule also made it possible to leave the debtor with

unfettered control of the collateral without running afoul of §60.

The fallacy in such a deduction is that *Benedict v. Ratner* did not deal with the substitution of collateral principle, and its reversal by §9-205 does not, indeed could not, change the conditions which must be met to make the principle applicable under §60. The preference section embodies an overriding federal policy decision that no creditor should be allowed to improve his position at the expense of other creditors at any time during the four months preceding bankruptcy. Only when a creditor can show that there has been a true substitution of collateral is that policy not offended. Thus, replacement of new collateral must precede or be simultaneous with release of old security, or a preference occurs. If the release occurs first, the creditor becomes unsecured and even a short delay in replacing the collateral is fatal under §60. In *National City Bank v. Hotchkiss,* 231 U.S. 50, 34 S. Ct. 20 (1913), for example, a bank which advanced money to a brokerage house in the morning was held to have received a preference when the loan was collateralized later the same day.

It follows that §9-205 does not make Rose City's situation analogous to *Pusey.* While there may be exceptions—particularly in cases where the security consists of relatively few items which do not change rapidly —a secured party who fails to police his collateral probably will be unable to demonstrate that the releases of collateral occurred at the requisite points in time.

In the trial before the Referee in Bankruptcy in this case, there was little if any evidence produced which would support an application of the substitution of col-

lateral theory. After Referee Snedecor's decision, but before the matter was presented to Judge Solomon on review, a stipulation was entered into setting forth the daily balances of the aggregate of the bankrupt's accounts receivable during the four months' period [Ex. 39]. From this data the substitution theory was argued to Judge Solomon. It was contended that the total outstanding receivables never fell below the amount needed to cover Rose City's claim of $53,122.26. Since new accounts came into existence on a daily basis in sufficient amounts to cover the old collateral collected and released, it is said to follow that the attaching of the security interest to new accounts necessarily preceded or was contemporaneous with the release of old ones to the extent necessary to protect Rose City's secured position.

The argument, however, lacks validity for a number of reasons. Some of the difficulty stems from the fact that the daily figures embodied in the stipulation represent raw data from the bankrupt's books which was not sifted through the fact-finding process of a trial court. The figures need further interpretation or clarification if they are to be meaningful at all. Thus, it has been argued that the daily credits shown in Exhibit 39 represent actual collections of accounts, *i.e.*, proceeds released to the bankrupt. Yet we do not know that this is so; it is entirely likely that to some extent at least the figures in the credit column reflect the writeoff of uncollectible accounts or the issuance of credit memos. Obviously, there is no release of collateral in substitution, no present consideration for the new accounts, if the credits do not reflect actual collections.

Moreover, the figures do not show the account balances during any given day; the books apparently show balances only at the end of a day. But this may be important, since, as seen above, a period as short as one day between the making of the loan and the giving of security can result in a preferential transfer.

Another difficulty is that the stipulation reflects gross totals of all receivables, without particularizing the amounts assigned to Rose City. The inadequate itemization is a problem since there was excepted from the assignment to Rose City those accounts which the debtor had assigned to R. Anthony DuBay and Robert J. Davis. Even if the transfers to DuBay and Davis are invalid, as both the Referee and Judge Solomon held, it is far from clear that either the debtor or Rose City intended those accounts to be security for Rose City's claim. On the contrary, there is evidence that the parties meant Rose City to have only those accounts not designated in the lists of receivables prepared for DuBay and Davis.[15]

This question becomes even more significant in light of the failure of Exhibit 39 to reflect the real value of

[15]The *Reporter* executed agreements wherein it undertook to assign certain of its accounts receivable to DuBay and Davis in July, 1962 and November 30, 1963, respectively [Exs. 15, 16]. Attached to each of those security agreements was a list of certain named account obligors. *Ibid.* Testimonial evidence would seem to establish that the parties intended Davis and DuBay to have all accounts which became owing at any time from those named account obligors [R. Tr. 86, 88-90, 94, 155]. At various times, including April 21, 1964, new lists of account obligors were prepared. [R. Tr. 155, 88-90]. While the courts below held the procedure invalid, the uncontradicted testimony is that in preparing the new lists the Reporter intended to comply with the DuBay and Davis agreements [R. Tr. 41-44], and that Rose City was intended to be secured only by those accounts not transferred to DuBay and Davis [R. Tr. 220-223].

the accounts, as distinguished from their book value, as of the beginning of the four months' period. The substitution theory requires that the collateral released be of at least equal value to that substituted for it. If the accounts assigned to Rose City as of the beginning of the period were worthless, or if they later became uncollectible, substitution of new accounts would be preferential. 3 COLLIER ON BANKRUPTCY, ¶60.21 at 864-5.

There is evidence that, in fact, the real value of the accounts assigned to Rose City was far less than the face amounts shown on the bankrupt's books. The book value of the accounts was $141,000 on September 28, 1964, and approximately $70,000 was billed thereafter [Ex. 39]. Yet of this total, the trustee was able to recover only a gross amount of approximately $127,000, and a net of only $107,000 after collection costs [Ex. 27].

It would thus appear that the bankrupt's accounts included substantial uncollectible items at the end of the business, and there is no reason to believe that the same condition did not exist during the preceding four months. Particularly since it is undisputed that the best accounts were to have been assigned first to DuBay and Davis [R. Tr. 75-76, 220-221, 223, 17, 157], the inference is permissible that Rose City might well have been virtually unsecured on any realistic basis at the beginning of the four months' period. The inability on this record to evaluate the valid security interest at the starting point—indeed, the impossibility of valuation at any time during the period—prevents application of the substitution of collateral theory.

E. The Policy of §60 Requires an Invalidation of Rose City's Security Interest.

It has been argued by some that despite the technical existence of the elements of a preference, §60 should be construed sympathetically in favor of Rose City's claim to the accounts in question because the attaching of its security interest to the after-acquired property did not involve the evils prohibited by §60. *E.g.,* Coogan & Bok, Friedman, Henson, note 3 *supra. But see* Viles, note 3 *supra* at 666-672; Hogan, *Future Goods, Floating Liens and Foolish Creditors,* 17 STAN. L. REV. 822 (1955). This being the case, there should be a reluctance to strike down the widely adopted principles of "good business practice" embodied in Article 9. Judge Solomon made much the same point in finding §9-108 reconcilable with federal law. We respectfully disagree.

Corn Exchange National Bank & Trust Co. v. Klauder, 318 U.S. 434, 63 S. Ct. 479 (1943), teaches that §60 must be applied to strike down transfers containing the defined elements of a preference even though the transaction in question does not involve the classic "midnight" transfer or secret lien, or the grab for assets on the eve of bankruptcy.

It has already been shown that the Code's floating lien provisions, insofar as after-acquired collateral is concerned, do involve a relation back effect that §60 is designed to stop. In Rose City's case, there was an even more fundamental violation of the federal policy of equitable distribution. This was not the usual commercial situation where an advance was made on the strength of receivables, with the lender at all times expecting liquidation of the loan from that source. Here repayment of the debt was of secondary importance.

The primary goal, which we do not disparage, was continuing publication of the newspaper as a public service [R. Tr. 108-109]. Indeed, Rose City agreed that DuBay and Davis could take the best accounts [R. Tr. 17, 75-76, 157, 220]; it made no effort to keep track of whether it was realistically secured or not. Only on the occasions when bankruptcy appeared imminent did Rose City assert the rights normally exercised by a secured party.[16] Although the Code's abolition of the rule of *Benedict v. Ratner* means that strict policing of collateral is no longer necessary to avoid the taint of fraud, the policy of §60 does not permit a lender to behave like an unsecured creditor up to the time of trouble, and then to take a secured stance. In any practical sense, this is the forbidden strengthening of position on the eve of bankruptcy.

Finally, we submit that to invalidate Rose City's security interest is not to interfere with "good business practice" or legitimate receivables financing under the Code. Despite §9-205, a prudent lender does supervise and control his collateral, and this is especially true after he has reasonable cause to believe the debtor is insolvent. Coogan et al., note 3, *supra* at §15.09 n. 47; Robinson, *New Value Concept Under the Code*, 73 Banking L. J. 78, 80 (1956); *Cf.* II Gilmore

[16]On February 26, 1964, the Reporter published a notice that due to a lack of funds it would cease publication on Saturday, February 29, 1964 [R. Tr. 146-147]. By letter dated February 27, 1964, Rose City directed the Reporter to transmit to it all cash proceeds collected from the assigned accounts [Ex. 39]. Upon resumption of publication on March 3, 1964, Rose City released all the proceeds collected and thereafter permitted the debtors to exercise unrestricted control of the collateral [Ex. 39] until after the Board of Directors of the bankrupt resolved that it would permanently cease publication on September 30, 1964 [C. Tr. 5; Ex. 39].

note 3 *supra* at 1340. He does so not only because of the potential problem under §60, but also to prevent loss of the security interest as a result of the debtor's dealing improperly with the collateral or commingling the proceeds so that they become unidentifiable. *Cf.* §9-306. Indeed, the printed UCC Form No. 1208 entitled "Accounts Receivable Loan and Security Agreement," which was actually used by Rose City, provides for a cash collateral account to regulate the debtor's disposition of proceeds [Ex. 17]. The striking of this provision by the parties without imposition of any comparable controls is one more indication that this case did not involve an ordinary financing transaction.

IV.

IF ROSE CITY'S SECURITY INTEREST IS UPHELD, THE CASE MUST BE REMANDED FOR FURTHER PROCEEDINGS.

Since Referee Snedecor held invalid the security interests asserted by all of the competing creditors, it was unnecessary for him to pass upon the trustee's contention that the senior DuBay and Davis claims should be preserved for the benefit of the bankrupt estate. The point became important, however, when Judge Solomon agreed with the Referee as to DuBay and Davis, but reversed in Rose City's case. If that decision is here affirmed in all respects, the question of whether the trustee can preserve or subrogate to the invalidated security interests should be considered. Otherwise, Rose City will receive a windfall as a result of the avoidance of the senior encumbrances.

Moreover, even if the DuBay and Davis interests were found not subject to preservation, there would

remain the unresolved factual issue of whether the contracting parties under such circumstances intended Rose City to have the DuBay and Davis accounts as security. Related accounting and identification problems will arise with respect to the funds collected after September 28, 1964, depending on how the foregoing questions are decided.

Thus, if Rose City's security interest is upheld, additional findings of fact seem necessary and a remand for further proceedings would appear appropriate to that end.

Conclusion.

For the foregoing reasons, the order below should be reversed to the extent it upheld the validity of the alleged security interest of Rose City Development Company, Inc.

Respectfully submitted,

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Certificate.

I certify that in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

George M. Treister

APPENDIX.

Statutes Involved.

Bankruptcy Act.

Section 60a(1), (2) (11 U.S.C. §96a(1), (2))

§60. *Preferred Creditors.* a. (1) A preference is a transfer, as defined in this Act, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition initiating a proceeding under this Act, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class.

(2) For the purposes of subdivisions a and b of this section, a transfer of property other than real property shall be deemed to have been made or suffered at the time when it became so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee. . . . [I]f any transfer is not so perfected against such liens by legal or equitable proceedings prior to the filing of a petition initiating a proceeding under this Act, it shall be deemed to have been made immediately before the filing of the petition.

Section 60b (11 U.S.C. §96b)

b. Any such preference may be avoided by the trustee if the creditor receiving it or to be benefited thereby or his agent acting with reference thereto

has, at the time when the transfer is made, reasonable cause to believe that the debtor is insolvent. . . .

Section 70c (11 U.S.C., §110c)

[The following is the pertinent portion of §70c as it existed prior to the 1966 amendment. The amendment of that year did not change the section in a manner material to the present case.]

c. The trustee may have the benefit of all defenses available to the bankrupt as against third persons, including statutes of limitation, statutes of frauds, usury, and other personal defenses; and a waiver of any such defense by the bankrupt after bankruptcy shall not bind the trustee. The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists.

Section 1(30) (11 U.S.C. §1(30))

(30) "Transfer" shall include the sale and every other and different mode, direct or indirect, of disposing of or of parting with property or with an interest therein or with the possession thereof or of fixing a lien upon property or upon an interest therein, absolutely or conditionally, voluntarily or involuntarily, by or without judicial proceedings, as a conveyance, sale, assignment, pay-

ment, pledge, mortgage, lien, encumbrance, gift, security, or otherwise; the retention of a security title to property delivered to a debtor shall be deemed a transfer suffered by such debtor;

Uniform Commercial Code.

Section 9-105 (ORS 79.1050)

79.1050 Definitions and index of definitions. (1) In ORS 79.1010 to 79.5070 unless the context otherwise requires:

. . . .

(c) "Collateral" means the property subject to a security interest, and includes accounts, contract rights and chattel paper which have been sold.

(d) "Debtor" means the person who owes payment or other performance of the obligation secured, whether or not he owns or has rights in the collateral, and includes the seller of accounts, contract rights or chattel paper. Where the debtor and the owner of the collateral are not the same person, the term "debtor" means the owner of the collateral in any provision of ORS 79.1010 to 79.-5070 dealing with the collateral, the obligor in any provision dealing with the obligation, and may include both where the context so requires.

Section 9-106 (ORS 79.1060)

79.1060 Definitions: "account"; "contract right"; "general intangibles." In ORS 79.1010 to 79.5070 unless the context otherwise requires:

(1) "Account" means any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper.

(2) "Contract right" means any right to payment under a contract not yet earned by performance and not evidenced by an instrument or chattel paper.

(3) "General intangibles" means any personal property (including things in action) other than goods, accounts, contract rights, chattel paper, documents and instruments.

Section 9-108 (ORS 79.1080)

79.1080 When after-acquired collateral not security for antecedent debt. Where a secured party makes an advance, incurs an obligation, releases a perfected security interest, or otherwise gives new value which is to be secured in whole or in part by after-acquired property his security interest in the after-acquired collateral shall be deemed to be taken for new value and not as security for an antecedent debt if the debtor acquires his rights in such collateral either in the ordinary course of his business or under a contract of purchase made pursuant to the security agreement within a reasonable time after new value is given.

Section 9-201 (ORS 79.2010)

79.2010 General validity of security agreement. Except as otherwise provided by the Uniform Commercial Code a security agreement is effective according to its terms between the parties, against purchasers of the collateral and against creditors. . . .

Section 9-203(1) (ORS 79.2030(1))

79.2030 Enforceability of security interest; proceeds, formal requisites. (1) . . . a security in-

terest is not enforceable against the debtor or third parties unless:

(a) The collateral is in the possession of the secured party; or

(b) The debtor has signed a security agreement which contains a description of the collateral. . . . In describing collateral, the word "proceeds" is sufficient without further description to cover proceeds of any character.

Section 9-204 (ORS 79.2040)

79.2040 When security interest attaches; after-acquired property; future advances. (1) A security interest cannot attach until there is agreement as defined in subsection (3) of ORS 71.2010 that it attach and value is given and the debtor has rights in the collateral. It attaches as soon as all the events in the preceding sentence have taken place unless explicit agreement postpones the time of attaching.

(2) For the purposes of this section the debtor has no rights:

. . .

(c) In a contract right until the contract has been made.

(d) In an account until it comes into existence.

(3) . . . a security agreement may provide that collateral, whenever acquired, shall secure all obligations covered by the security agreement. . . .

Section 9-205 (ORS 79.2050)

79.2050 Use or disposition of collateral without accounting permissible. A security interest is not invalid or fraudulent against creditors by rea-

son of liberty in the debtor to use, commingle or dispose of all or part of the collateral (including returned or repossessed goods) or to collect or compromise accounts, contract rights or chattel paper, or to accept the return of goods or make repossessions, or to use, commingle or dispose of proceeds, or by reason of the failure of the secured party to require the debtor to account for proceeds or replace collateral. This section does not relax the requirements of possession where perfection of a security interest depends upon possession of the collateral by the secured party or by a bailee.

Section 9-301 (ORS 79.3010)

79.3010 Persons who take priority over unperfected security interest; "lien creditor." (1) . . . an unperfected security interest is subordinate to the rights of:

. . . .

(b) A person who becomes a lien creditor without knowledge of the security interests and before it is perfected.

. . . .

(3) A "lien creditor" means a creditor who has acquired a lien on the property involved by attachment, levy, or the like and includes an assignee for benefit of creditors from the time of assignment, and a trustee in bankruptcy from the date of the filing of the petition or a receiver in equity from the time of appointment. Unless all the creditors represented had knowledge of the security interests such a representative of creditors is a lien creditor without knowledge even though he personally has knowledge of the security interest.

Section 9-302 (ORS 79.3020)

79.3020 When filing is required to perfect security interest; security interests to which filing provisions of ORS 79.1010 to 79.5070 do not apply. (1) A financing statement must be filed to perfect all security interests except the following:

[none of the listed exceptions is material to this case]

Section 9-303(1) (ORS 79.3030(1))

79.3030 When security interest is perfected; continuity of perfection. (1) A security interest is perfected when it has attached and when all the applicable steps required for perfection have been taken. . . . If such steps are taken before the security interest attaches, it is perfected at the time when it attaches.

Section 9-306 (ORS 79.3060)

79.3060 "Proceeds"; secured party's rights on disposition of collateral. (1) "Proceeds" includes whatever is received when collateral or proceeds is sold, exchanged, collected or otherwise disposed of. The term also includes the account arising when the right to payment is earned under a contract right. Money, checks and the like are "cash proceeds." All other proceeds are "noncash proceeds."

(2) Except where ORS 79.1010 to 79.5070 otherwise provide, a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof by the debtor unless his action was authorized by the secured party in the security agreement or otherwise, and also continues in

any identifiable proceeds including collections received by the debtor.

(3) The security interest in proceeds is a continuously perfected security interest if the interest in the original collateral was perfected but it ceases to be a perfected security interest and becomes unperfected 10 days after receipt of the proceeds by the debtor unless:

(a) A filed financing statement covering the original collateral also covers proceeds; or

(b) The security interest in the proceeds is perfected before the expiration of the 10-day period.

(4) In the event of insolvency proceedings instituted by or against a debtor, a secured party with a perfected security interest in proceeds has a perfected security interest:

(a) In identifiable noncash proceeds;

(b) In identifiable cash proceeds in the form of money which is not commingled with other money or deposited in a bank account prior to the insolvency proceedings;

(c) In identifiable cash proceeds in the form of checks and the like which are not deposited in a bank account prior to the insolvency proceedings; and

(d) In all cash and bank accounts of the debtor, if other cash proceeds have been commingled or deposited in a bank account, but the perfected security interest under this paragraph (d) is:

(A) Subject to any right of setoff; and

(B) Limited to an amount not greater than the amount of any cash proceeds received by the debt-

or within 10 days before the institution of the insolvency proceedings and commingled or deposited in a bank account prior to the insolvency proceedings less the amount of cash proceeds received by the debtor and paid over to the secured party during the 10-day period.

. . . .

Section 9-401(1) (ORS 79.4010(1))

79.4010 Place of filing; erroneous filing; removal of collateral. (1) The proper place to file in order to perfect a security interest is as follows:

. . . .

(c) . . . in the office of the Secretary of State and in addition, if the debtor has a place of business in only one county of this state, also in the office of the county clerk . . .

Section 9-402(1) (ORS 79.4020(1))

79.4020 Formal requisites of financing statement; amendments. (1) A financing statement is sufficient if it is signed by the debtor and the secured party, gives an address of the secured party from which information concerning the security interest may be obtained, gives a mailing address of the debtor and contains a statement indicating the types, or describing the items, of collateral. . . .